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No. 05-1664

IN THE
Supreme Court of the United States

U.S. BANK NATIONAL ASSOCIATION,

Petitioner,

v.

UNITED AIR LINES, INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF IN OPPOSITION

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TABLE OF CONTENTS

Page

CORPORATE DISCLOSURE STATEMENT ii

TABLE OF AUTHORITIES iii

INTRODUCTION 1

COUNTERSTATEMENT OF THE CASE 2

A. Factual Background 2

B. Procedural History 3

REASON FOR DENYING THE WRIT 4

The Petition Challenges the Seventh Circuit's Interpretation and Application of State Law. 4

CONCLUSION 7

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, Respondent United Air Lines, Inc. states that it is a wholly owned subsidiary of UAL Corporation, which is a publicly held company.

TABLE OF AUTHORITIES

Page(s)

Cases

Burks v. Lasker,
441 U.S. 471 (1979) 4

Butner v. United States,
440 U.S. 48 (1979) 5

Citizens Bank of Md. v. Strumpf,
516 U.S. 16 (1995) 5

Norwest Bank Washington v. Ahlers,
485 U.S. 197 (1988) 6

Raleigh v. Illinois Dep't of Revenue,
530 U.S. 15 (2000) 5, 7

Statutes

11 U.S.C. § 105 6

11 U.S.C. § 553(a) 4, 5

Cal. Civ. Code § 3529 3

Other Authorities

Stern, Robert, L. *et al.*,
Supreme Court Practice (8th ed. 2002) 4

INTRODUCTION

This Court should deny the petition for the simple and straightforward reason that it presents no question of federal law. This case hinges on the question whether respondent United Air Lines had a property interest in certain disputed funds when it filed for bankruptcy. (If it did, then petitioner U.S. Bank National Association is required to pay United those funds forthwith; if it did not, then U.S. Bank is entitled to set off those funds against United's debts.) As U.S. Bank acknowledged below, that question is governed by state law: "[p]roperty interests are created and defined by state law," and it thus follows that "[t]he ultimate question presented is whether, *under California law*," United possessed a property interest in the disputed funds when it filed for bankruptcy. Br. of Appellant, 7th Cir. No. 05-1752, at 10-11 (emphasis added; internal quotation omitted). Not surprisingly, both the majority and the dissent in the Seventh Circuit also recognized that this question was governed by state, not federal, law. *See* Pet. App. 9-16a, 19a, 28a.

U.S. Bank, however, now attempts to raise a federal question by suggesting that the lower courts relied on their equitable authority under *federal* law. They did not: at every stage of the proceeding below, both the courts and the litigants recognized that the issue was whether equitable principles under *California* law gave United a property interest in the disputed funds when the company filed for bankruptcy. Reasonable jurists can certainly argue about that issue, but it obviously presents no federal question for this Court's review. This Court does not sit to determine the appropriate scope of equity under California law. Accordingly, this Court should deny the petition.

COUNTERSTATEMENT OF THE CASE

A. Factual Background

In 2001, a set of agreements were established to finance the construction of a new cargo terminal at Los Angeles International Airport (LAX). Pet. App. 2a. At that time, the California Statewide Development Authority issued bonds in the amount of $34,590,000 to provide funding for the terminal. *Id.* at 3a. U.S. Bank serves as trustee for those funds under a Trust Agreement between U.S. Bank and the Authority. *Id.* at 4a. As trustee, U.S. Bank is responsible for reimbursing United for incurred construction costs "upon receipt" of a written request. *Id.* Under a contemporaneous Payment Agreement between United and the Authority, United agreed to make payments of principle and interest on the bonds. *Id.*

This system worked fine until December 2002, "when United's bankruptcy filing appeared imminent." *Id.* Before December 5, 2002, "U.S. Bank had summarily granted each request for construction funds without making any attempt to substantiate it." *Id.* at 4a-5a. On that date, "as newspapers across the country reported that United teetered on the brink of bankruptcy," United requested payment of $1.92 million (the so-called Category III funds) as reimbursement for costs incurred on the LAX project. *Id.* at 5a. U.S. Bank, however, took no action on that request, and United filed for Chapter 11 bankruptcy protection on December 9, 2002. *Id.*

Once in bankruptcy, United "ceased paying the principal and interest on the bonds," and thereby defaulted on its obligations under the 2001 agreements. *Id.* U.S. Bank thereafter refused to pay United the Category III funds, insisting that it was entitled to keep these funds as a setoff against amounts not paid by United.

B. Procedural History

United thereafter filed an adversary proceeding against U.S. Bank in the U.S. Bankruptcy Court for the Northern District of Illinois (where the underlying bankruptcy proceeding was pending), alleging that U.S. Bank was not entitled to a setoff. The bankruptcy court (Wedoff, J.), agreed. The court held that U.S. Bank had violated a non-discretionary duty under California law to pay United the Category III funds upon request, and that United thereby obtained a property right to those funds under California law at that time. Pet. App. 62-70a. The upshot of that conclusion was that U.S. Bank had no right to a setoff under California law, because under California law the payment was deemed paid when it should have been paid. *See id.*

U.S. Bank appealed, and the district court (Darrah, J.) affirmed. Again, the court recognized that "California law governs" this issue. *See id.* at 47a. As the court explained, "California has codified the common law equitable maxim that 'which ought to have been done is to be regarded as done, in favor of him to whom, and against him from whom, performance is due.'" *Id.* (quoting Cal. Civ. Code § 3529). As the court noted, "it would be inequitable to allow US Bank the right to a setoff merely because United filed for bankruptcy when that right did not exist at the time the payment to United was due." *Id.* at 48a. Because "the equitable transfer of the funds created ownership by United," no setoff was permissible under California law. *Id.*

U.S. Bank again appealed, and a divided panel of the Seventh Circuit affirmed. Once again, the majority (Cudahy, J., joined by Manion, J.) held that, "[u]nder California law," *id.* at 15a, U.S. Bank had no discretion to deny United payment upon demand, *see id.* at 9-16a, 19a. The majority further recognized that "[t]he California courts, like courts of other jurisdictions, rely on a number of equitable doctrines in different situations to provide

the relief required to redress a plaintiff's injuries when the law is unable to do so." *Id.* at 20a. The majority held that one such equitable doctrine, constructive receipt, "has the same basic thrust as the equitable maxim that the bankruptcy court relied upon," and applied here. *Id.* at 21a; *see also id.* at 22a ("The California courts are willing to apply extralegal remedies in situations where the equities demand it."). Applying that maxim, the majority concluded that United must be deemed to have received the funds before filing for bankruptcy, and hence no setoff was permissible. *Id.* at 23a. Judge Sykes dissented on this point of California law. *See id.* at 28a (emphasizing that "[s]tate law governs the determination of the nature and scope of the property interests that comprise the property of the estate in bankruptcy, as well as the setoff rights that are preserved under § 553(a) of the Bankruptcy Code," and "[i]n California (as in other states) law—not equity—provides the usual remedy for breach of contract") (citations and internal quotation omitted).

U.S. Bank sought rehearing *en banc*, but "no judge in active service ... requested a vote" on the petition, and "all of the judges on the original panel ... voted to deny rehearing." *Id.* at 73a. U.S. Bank now seeks this Court's review.

REASON FOR DENYING THE WRIT

The Petition Challenges the Seventh Circuit's Interpretation and Application of State Law.

This petition should be denied in light of the fundamental principle that this Court does "not grant certiorari to decide a question of state law." *Burks v. Lasker*, 441 U.S. 471, 486 (1979) (internal quotation and brackets omitted); *see generally* Robert L. Stern *et al.*, *Supreme Court Practice* § 4.10, at 242-43 (8th ed. 2002).

Both of the questions presented here challenge the lower courts' invocation of equitable principles to prevent

U.S. Bank from offsetting its debt to United against United's debt to U.S. Bank. *See* Pet. i. Both of the questions suggest that the lower courts purported to derive such equitable authority from some federal source. That suggestion is manifestly incorrect.

As this Court has often recognized, federal bankruptcy law operates against the backdrop of rights and obligations created by state law. *See, e.g., Raleigh v. Illinois Dep't of Revenue*, 530 U.S. 15, 20 (2000); *Butner v. United States*, 440 U.S. 48, 54 (1979). In particular, the Bankruptcy Code does not determine whether U.S. Bank is entitled to a setoff here; state law does. *See Citizens Bank of Md. v. Strumpf*, 516 U.S. 16, 18 (1995) ("[N]o federal right of setoff is created by the Bankruptcy Code, [which] provides that, with certain exceptions, whatever right of setoff otherwise exists is preserved in bankruptcy."). The question here, then, is whether U.S. Bank is entitled to a setoff under California law.

The answer to that question, as the Seventh Circuit explained, turns on the principle that "[u]nder California law as preserved in [Section 553(a) of] the Bankruptcy Code, mutual *debts* arising before the commencement of a bankruptcy proceeding may be offset, subject to certain exceptions not relevant here." Pet. App. 16a (emphasis added); *see also id.* ("California law and § 553(a) require that, for setoff to apply, debts be between the same parties and that both arise before the filing of the bankruptcy petition."); *id.* at 19a ("California law expressly extends setoff rights to bankruptcy filings in situations where the creditor and the debtor share a mutual debt."); *cf.* Pet. 13 (recognizing that § 553(a) "*preserves* setoff rights") (emphasis added). That is why the crux of this dispute is whether U.S. Bank owed United a "debt" before the bankruptcy filing, or whether (as an equitable matter) United is deemed to have constructively received those funds before the filing.

That issue once again turns on California law. Thus, in deciding that United was deemed to have received the funds from U.S. Bank at the time they were due, the bankruptcy court, the district court, and the Seventh Circuit majority all turned to equitable principles under California law. *See* Pet. App. 19-23a, 47-48a, 65-70a. The dissent in the Seventh Circuit did not challenge the proposition that this issue was governed by California law, but simply argued that California would not apply equitable principles under these circumstances. *See id.* at 28a.

U.S. Bank thus misses the point by its generic challenge to the lower courts' invocation of equity in this case. Whether federal courts are entitled to invoke equity under *federal* law presents a federal issue; whether federal courts are entitled to invoke equity under *state* law does not. Here, despite U.S. Bank's best efforts at obfuscation, only state-law equitable principles are in dispute.

Accordingly, Section 105 of the Bankruptcy Code, 11 U.S.C. § 105, which gives bankruptcy courts certain equitable powers under federal law, is not implicated here—which may explain why none of the lower courts in this case relied on that provision. The extent to which there may be "dramatic disagreement throughout the case law at the circuit court, district court, and bankruptcy court levels" about the proper scope of § 105, Pet. 17, is thus immaterial, since this is not a § 105 case.

Similarly, this Court's decision in *Norwest Bank Washington v. Ahlers*, 485 U.S. 197, 207 (1988), which held that courts may not depart from the text of the Bankruptcy Code by invoking general equitable principles, has no bearing here. The lower courts in this case did not "invoke equity to avoid a result *otherwise required* by the provisions of the Bankruptcy Code." Pet. 21 (emphasis added). As noted above, the Bankruptcy Code operates against the backdrop of rights and

obligations derived from state law in the first instance, and hence the Bankruptcy Code did not "require" any result here unless and until the antecedent state-law rights and obligations were established. *See, e.g., Raleigh*, 530 U.S. at 20 ("Creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code."). Because United had constructive possession of the disputed funds under California law before filing for bankruptcy, U.S. Bank was not entitled to a setoff under California law, and nothing in the Bankruptcy Code "otherwise require[s]," Pet. 21, a different result.

At the end of the day, whether the decision below is right or wrong with respect to the application of equitable principles under California law presents no question worthy of this Court's review. The courts of California sit to provide definitive answers on matters of California law; this Court does not.

CONCLUSION

For the foregoing reasons, this Court should deny the petition for writ of *certiorari*.

Respectfully submitted,

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